BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer	Chair
Marshall Johnson	Commissioner
Ken Nickolai	Commissioner
Thomas Pugh	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of a Petition by Great Plains Natural Gas Company, a Division of MDU Resources Group, Inc., for Authority to Increase Natural Gas Rates in Minnesota

ISSUE DATE: May 1, 2006

DOCKET NO. G-004/GR-04-1487

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER

PROCEDURAL HISTORY

I. INITIAL PROCEEDINGS

On September 7, 2004, Great Plains filed a general rate case petition. In its filing, Great Plains requested a rate increase of $1,436,026, or approximately 4.0 percent over existing rates. Great Plains also filed a Petition for Interim Rates in the amount of $1,436,026.

On November 1, 2004, the Commission issued Orders allowing Great Plains to complete its petition as of a future date, suspending rates, and setting the matter for contested case hearings. The Office of Administrative Hearings assigned Administrative Law Judge (ALJ) Richard C. Luis to the case.

Great Plains' filing was certified as complete on November 12, 2004. The revised Petition requested a rate increase of $1,365,682 or 3.8 percent over existing rates.

On November 23, 2004, the Commission issued an Order setting interim rates, authorizing an interim rate of approximately $1,365,746, for service rendered on and after January 10, 2005.

In its November 1, 2004, Order setting the matter for hearing, the Commission directed the parties to address the following issues in the course of the contested case proceedings: 1) Is the test year revenue increase sought by the Company reasonable or will it result in unreasonable and excessive earnings by the Company? 2) Is the rate design proposed by the Company reasonable? 3) Are the Company's proposed capital structure and return on equity reasonable? 4) Are the Company's service extensions and service extension policies consistent with applicable statutes and rules, Commission directives, and the public interest? 5) Are the Company's cost allocation policies and processes consistent with applicable statutes and rules, Commission directives, and the public interest? 6) Are the Company's customer charge proposals consistent with applicable statutes and rules, Commission directives, and the public interest? In addition, the Commission required filings regarding service line extensions and other tariff issues.

The ALJ held a prehearing conference on December 14, 2004, and issued a Prehearing Order on January 26, 2005.

II. PARTIES AND REPRESENTATIVES

A. The Department

The Department of Commerce was represented by Vincent Chavez, Gas Division Supervisor for the Minnesota Department of Commerce (the Department) and Julia Anderson, Assistant Attorney General, 445 Minnesota Street, Suite 1400, Saint Paul, MN 55101

B. The Company

Great Plains was represented by Brian M. Meloy, Leonard, Street and Deinard P.A., 150 South Fifth Street, Suite 2300, Minneapolis, MN 55402, and Donald R. Ball, Great Plains, 400 N. Fourth Street, Bismarck, ND 58501-4092.

III. PUBLIC HEARINGS AND PUBLIC TESTIMONY

The ALJ held public hearings to receive comments and questions from non-intervening ratepayers. Public hearings were held by means of video conferences in the afternoon and evening of
April 19, 2005. Company representatives and a representative from the Department of Commerce appeared at video conference locations in Fergus Falls, Marshall and Crookston.

Persons who attended the video conference expressed concern about the proposed residential rate increase, stating that bills had gotten "outrageous" since Great Plains was "taken over" by MDU, and that consumers "felt helpless." One woman complained that the company's proposed increase to its basic service charge, from $5.50 to $8.00 would lead to confusion about how much of one's bill was based on consumption of gas.

The ALJ also received letters from ratepayers. One writer said he was "fed up" with "phantom" charges for distribution costs and franchise fees. Another alleged that the company used its natural gas bills to subsidize the discounts it offered in its non-regulated appliance sales operation. Other complaints included that the company's 3.8 percent increase request was higher than the rate of inflation, and that senior citizens on fixed incomes had difficulty meeting their heating bills in the winter.

IV. EVIDENTIARY HEARING

Evidentiary hearings were held on July 20 - 22, 2005.

V. PROCEEDINGS BEFORE THE COMMISSION

On November 7, 2005, the ALJ filed his final report and recommendation.

On February 7, 2006, the Commission heard oral argument from the parties. On February 9, 2006, the Commission met to deliberate the matter.

Upon review of the entire record of this proceeding, the Commission makes the following Findings of Fact, Conclusions of Law, and Order.

FINDINGS AND CONCLUSIONS

VI. JURISDICTION

The Commission has general jurisdiction over the Company under Minn. Stat. §§ 216B.01 and 216B.02. The Commission has specific jurisdiction over rate changes under Minn. Stat. § 216B.16.

The case was properly referred to the Office of Administrative Hearings under Minn. Stat. §§ 14.48 - 14.62 and Minn. Rules, part 1400.2000 et seq.

On May 15, 205, Great Plains filed a motion to unconditionally waive its right to implement rates. The Company's motion as revised was granted by the ALJ in an Order issued June 3, 2005. As a condition of receiving its requested waiver to the statutory timelines, the Company affirmatively waived its right to have its proposed natural gas rates take effect September 12, 2005.

VII. THE COMPANY

Until 2000, Great Plains was an investor-owned utility, providing natural gas to 18 western Minnesota communities and one North Dakota community. Great Plains served approximately 20,000 Minnesota customers and 2,000 North Dakota customers. In June 2000, Great Plains and Montana-Dakota Utilities Resources Group, Inc. (MDU) merged. MDU has a utilities division, structured as a subsidiary, Montana-Dakota Utilities Co. (MD Utilities) that provides natural gas to over 200,000 customers and electric service to over 100,000 customers in North Dakota, South Dakota, Wyoming and Montana.

Since the merger, MDU operates the natural gas utility service of Great Plains as a division of MD Utilities. Great Plains' natural gas distribution assets comprise four-tenths of one percent of MDU. It accounts for 1.7 percent of MDU's revenues. Great Plains estimates that it serves 20,900 customers in Minnesota, 86 percent residential, 13 percent firm general service, and 1 percent interruptible sales and transportation. Great Plains' operations are directed from Fergus Falls, Minnesota.

VIII. BURDEN OF PROOF

Minn. Stat. § 216B.16, subd. 4 states: "The burden of proof to show that the rate change is just and reasonable shall be upon the public utility seeking the change." Under Minn. Stat. § 216B.03, every rate made, demanded or received by any public utility " . . . shall be just and reasonable. . . Any doubt as to the reasonableness should be resolved in favor of the consumer."

The utility faces a two prong burden of proof in a rate case. When presenting its case in the rate case proceeding, the utility bears the burden to prove its facts by a fair preponderance of the evidence. The utility also has the burden to prove, by means of a process in which the Commission uses its judgment to draw inferences and conclusions from proven facts, that the proposed rates are just and reasonable.

IX. THE TEST YEAR

Great Plains proposed using the per books financial information for the calendar-year base period ending December 31, 2003, as the basis for projecting a test year (2005) to determine the revenue deficiency to be remedied by this proceeding. [1]

The Department did not object to the Company's proposal to use a projected test year in this case. The Department did, however, object to Great Plains' test year budget. The Department asserted that Great Plains failed to show that its expenses in the base year are reasonable. Great Plains used a projected average 2005 test year, developed from the 2003 actual results and further adjusted.

CONTESTED ISSUES

X. ESTABLISHMENT OF TEST YEAR EXPENSES: MERGER ORDER IMPACT

A. Background

Setting just and reasonable rates involves establishing the utility's expenses during a test year and the revenues it projects for that test year based on current rates, projected sales, and rate structure. The Company's revenue deficiency is then calculated as the difference between the return on rate base and the net of the utility's test year expenses and test year revenues. The Commission then proceeds to consider what rate structure would be appropriate to recover the revenue deficiency.

In this section, the Commission considers an issue fundamental to the establishment of the utility's test year expenses. Great Plains has proposed to use 2003 actual expenses as a basis to project its test year expenses. The Department countered that the proper starting point for calculating the Company's test year expenses were the last Commission-approved expenses from Great Plain's last rate case, Docket No. G-004/GR-02-1682. The Department objected that using the Company's 2003 actual expenses was inappropriate for several reasons, one of which relates to a limitation applied to Great Plains by the Commission when the Commission approved the Company's merger with MDU Resources Group.

Specifically at issue in this section, therefore, is the effect of Order Paragraph 3 of the MERGER ORDER, which stated the following as a condition of approving the merger between Great Plains and MDU Resources Group, Inc.:

---

[1] Projected test year methodology has been accepted in past rate cases, where the projected test year can be shown to produce reliable results. *See. e.g., ITMO the Application of Northern States Power Company for Authority to Increase its Rates for Electric Service in the State of Minnesota,* Docket No. E-002/GR-91-1 (Findings of Fact, Conclusions of Law and Order November 27, 1991).

> Petitioners [Great Plains and MDU] shall hold Minnesota ratepayers harmless as to any increase in Great Plains' cost of service resulting from the merger.[2]

B. Great Plains' Proposal

As part of its proposed rate increase, Great Plains sought to include in test year expenses the Company's actual operation and maintenance (O&M) expenses for 2003, some of which were allocated or directly assigned to the Company by its parent MDU. Great Plains asserted that these costs were allocated based upon services provided to Great Plains. In this proceeding, these O&M costs have been referred to as "corporate costs."

C. The Department

The Department opposed using some of these costs in calculating the Company's test year expenses on the basis that they are precluded by the Commission's Merger Order unless the Company can show that they are properly attributable to Great Plains as a stand-alone company (pre-merger Great Plains) and not the result of the merger.

The Department argued that the Company's interpretation that the Order's "hold harmless" requirement applied only to the "next rate case" was overly restrictive and inconsistent with the Commission's expansive language prohibiting the imposition of "any" post-merger costs. The Department argued that the Company's interpretation would require the Commission to accept the absurd result that the Company, while prohibited from shifting any merger costs onto ratepayers in the first post-merger rate case, conceivably could impose an enormous amount of merger costs on ratepayers in subsequent cases.

D. The ALJ

The ALJ noted that the Commission placed no time limitation on the above-quoted restriction and stated:

> The [Merger Order's] "resulting from the merger" limitation imposes an independent restriction on what costs can be allocated where, as here, functions formerly conducted by officers and employees of the pre-merger Great Plains are now conducted by officers and employees of MDU, without direct identification of time and duties.

The ALJ applied the above-cited Merger Order requirement to Great Plains' proposal to include in rates projected test year operation and maintenance expenses for 2005, some of which were allocated or directly assigned to the Company by its parent MDU. In so doing, the ALJ stated:

---

[2] In the Matter of a Request by Great Plains Natural Gas Company for Approval to Merge Great Plains Energy Corp. and its Subsidiary, Great Plains Natural Gas Company, with MDU Resources Group, Inc., Docket No. G-004/PA-00-184, ORDER ACCEPTING STIPULATION AND AGREEMENT AND APPROVING MERGER SUBJECT TO CONDITIONS (June 13, 2000), Order Paragraph 3, page 6 (Merger Order).

35. MDU is free to structure its corporate operations in any manner it pleases. But this freedom does not mean that the costs of that structure are allowable as allocated costs to Great Plains. The Company has asserted that "targeted efforts to increase operational efficiencies and minimize costs" were made. [Footnote omitted.] But at the same time, the actual costs identified by Great Plains in 2003 are far higher than the comparable corporate costs for premerger Great Plains for the same year. [Footnote omitted.] Great Plains must show that the costs to be allocated are reasonable. This can be done by demonstrating, on a functional basis, that the duties and responsibilities of an allocated position are directly replacing a position that existed with the pre-merger Great Plains. Similarly, new costs that arise independently of the merger that would have been costs incurred by a stand-alone Great Plains are appropriately allocated in rate setting proceedings under the provisions of the Merger Order.[3]

E. Great Plains Exception to the ALJ's Findings and Recommendation Regarding Recovery of "Corporate Costs"

Great Plains asserted that it has demonstrated that the corporate costs it seeks to recover are not "comparable 1999 costs adjusted for inflation" as that phrase appears in Merger Order Paragraph 6 and hence are not barred from recovery by that Order Paragraph. The Company also argued that it had demonstrated that the increased costs in question do not "result from the merger" so as to be barred by Merger Order Paragraph 3.

Moreover, Great Plains also argued both that any restriction on the recovery of the corporate costs at issue in this section was limited to the Company's "next Minnesota rate case" and expired upon implementation of final rates in Docket No. G-004/GR-02-1682.

Finally, the Company also noted that the Commission's Merger Order stated that the Commission "accepts the Stipulation and Agreement filed by petitioners on April 4, 2000." The Company asserted that, in doing so, the Commission was accepting the temporal limitation ("in the next rate case") stated in that Stipulation and Agreement.[4]

F. Commission Analysis and Action

The Commission concludes that the language of the Merger Order requiring that ratepayers not be harmed by the merger requires the Company to prove that new expenses or increases in expenses are not the result of the merger before they can be included as test year expenses.

Great Plains has misinterpreted the language in the Merger Order referring to what the Company is required to do "in its next rate case," i.e., not to seek to recover **corporate costs** exceeding its comparable corporate costs for the twelve months ending December 31, 1999. The Company interpreted this to mean that it would be free, after "its next rate case," to recover **any** costs (not just corporate costs, which are uniquely subject to the "next rate case" limitation) without regard

---

[3] ALJ's Report, page 11, Paragraph 35.

[4] Companies' Stipulation and Agreement Regarding Future Cost Recovery filed April 4, 2000 in Docket No. G-004/PA-00-184.

to the level of pre-merger costs, i.e., those costs incurred during the twelve months ending December 31, 1999, adjusted for inflation. The Company's interpretation is not reasonable because it ignores its specific agreements not to seek to recovery of merger-related costs from Minnesota ratepayers "in any future rate case." Nothing in the Merger Order put time limits on the condition of holding ratepayers harmless from cost increases resulting from the merger.

Under the Merger Order's hold-harmless requirement, any post-merger cost that is greater than a pre-merger cost due to the merger is not appropriate for recovery. Contrary to the Company's assertion, the Commission finds that the Company, which has the burden of proof that its post-merger costs are appropriate, has not shown that its 2003 actual costs are just and reasonable in relationship to the pre-merger costs. Enforcement of its hold-harmless guarantee requires reviewing the last costs considered appropriate by the Commission then allowing appropriate adjustments based on record evidence. The ALJ's Report at Paragraph 35 states how this is to be done and the Commission concurs in those findings.

XI. COST OF CAPITAL

A. Summary of the Commission's Conclusion

Having reviewed the record and the arguments of all parties, the Commission finds that the Department's DCF analysis appropriately represents Great Plains' cost of equity. The Commission will adopt the Department's proposed cost of equity, 9.72 percent, and the resulting 8.96 percent rate of return.

The Commission will first address Great Plains' cost of equity proposal (Sections B and C) and then address the Department's (Sections D-G).

B. Great Plains' Cost of Equity Proposal

Great Plains' proposed capital structure, cost of long term debt, cost of preferred stock, and test year cost of capital as follows:

	Ratio	Cost Rate	Weighted Cost of Capital
Long Term Debt	43.535%	8.518%	3.708%
Preferred Stock	4.557%	4.614%	0.210%
Common Equity	51.908%	11.000%	5.710%
Totals	100.000%		9.628%

Great Plains requested a return on equity (ROE) of 11 percent. The Company's expert witness arrived at the 11 percent figure by finding the average of ROEs from his comparison group and applying two upward adjustments: 1) an upward adjustment to account for what he asserted were unique risks faced by Great Plains: extremely small size, lack of customer and geographic diversity, rate design limitations (lack of weather normalization), and historically low to negative returns and 2) a flotation cost adjustment of 4.75 percent.

C. The Department's Objections to Great Plains' Proposed Cost of Equity

The Department did not dispute the Company's proposed capital structure, cost of long term debt, or cost of preferred stock,[5] but did dispute the Company's DCF analysis and resulting proposed cost of capital on three grounds. The Department argued that the Company's proposed ROE was inappropriate because the Company 1) treated risk factors improperly, 2) included KeySpan in its comparison group, and 3) improperly calculated a flotation cost adjustment.

1. Great Plains' Assessment of Risk and Consequent Risk Adjustment

a. Great Plains

Great Plains claimed that it faces unique risks primarily due to 1) its small size, 2) lack of geographic and customer diversity, 3) rate design limitations (rates not weather normalized), and 4) historically low to negative returns.

b. The Department

The Department stated that size alone does not warrant a separate adjustment outside the initial consideration by Standard & Poor's in developing MDU's bond rating. Moreover, the Department stated, Great Plains is a regulated monopoly that has market power. As a consequence, the Department argued, Great Plains' relatively small size in comparison to other companies in the Department's Comparison Group does not translate into greater risk for the Company. As to the asserted lack of geographical and customer diversity, the Department stated that record does not substantiate the claim. Moreover, the Department stated, this factor would have been considered by Standard & Poor's in developing a bond rating for MDU. As to the rate design factor and the Company's low profitability for the past several years, the Department stated that Standard & Poor's considered these among other factors in arriving at MDU's bond rating.

c. The ALJ

The ALJ agreed with the Department that risk is already included in MDU's bond rating, which the ALJ stated was the initial starting point for the ROE calculation. The ALJ stated that there is no basis for reintroducing risk as a stand-alone factor for determining ROE since the elements identified as comparative risk factors are already contained in the ratings for the comparison group companies and to do so would overemphasize one factor in the calculation and distort the results. The ALJ also stated that perceptions of higher risk were subjective perceptions, not quantified by a comparison to information from any other companies in the comparison group.

d. Great Plains Exceptions

In its exceptions to the ALJ's Report, Great Plains argued that the ALJ's findings overlooked substantial evidence in the record that the bond ratings for the proxy companies do not adequately

---

[5] As indicated in the Uncontested Issues section of this Order, the Department and the ALJ supported the Company's proposed capital structure, cost of long term debt, and cost of preferred stock, and the Commission found these items within the range of regulatory reasonableness and supported by substantial evidence.

reflect the risk faced by Great Plains. The Company continued to allege that it faced greater risks than any other companies in the comparison groups and disputed the ALJ's conclusion that the Company's assertions were "subjective perceptions, not quantified by a comparison to information from any other companies in the comparison group." Great Plains requested that the Commission reject ALJ Finding of Fact 74 and replace it with the following:

> 74. The record in this case reflects the fact that Great Plains appropriately factored the unique business and financial risks faced by Great Plains in proposing an ROE of 11%, while the Department systematically ignored these risks.

e. The Commission's Analysis

The Commission finds that the ALJ's conclusion is correct and will not adopt the Company's proposed revised Finding #74. The ALJ correctly found:

> The elements identified [by the Company] as comparative risk factors are already contained in the ratings of the comparison group companies. There is no basis for reintroducing risk as a stand-alone factor in determining ROE. To do so would overemphasize one factor in the calculation and distort the results obtained.

The Department did not ignore the four risks asserted by the Company, but (as noted above) addressed each one, demonstrating in each instance that the asserted factor was either non-impacting or negligibly impacting and would have been taken into account by Standard & Poor's in setting relevant bond ratings. The Department and the ALJ also properly noted that in selecting to emphasize only four of the multiple factors involved in risk assessment, the Company has sought a one-sided and incomplete consideration of risk that would effectively double count factors already taken into account.

The Commission further notes that the Company has requested the Commission approve an "increased risk premium" without providing any calculations or studies in the record to quantify the amount of upward adjustment it claimed was due in response to the various risk factors that it asserted.

2. Exclusion of Keystone from the Comparison Group

a. Great Plains' Proposal

Although it proposed an ROE of 11 percent, Great Plains' 11 member Proxy Group contained only two companies (Atmos Energy and KeySpan Corporation) that had an ROE of more than 10 percent. KeySpan had an ROE of 10.30 percent.

b. The Department and the ALJ

The Department argued and the ALJ agreed that KeySpan should not be considered as part of any comparison group because KeySpan is much larger than any of the other companies in either comparison group (three times the assets, three times the operating revenue, and four times the operating income of any other company in either group) and did not meet the Department's earnings screen: a requirement that the company earn 65 percent of its operations-derived revenue from its natural gas operations.

c. Great Plains' Exceptions to the ALJ's Finding Regarding KeySpan

Great Plains asserted that KeySpan Corporation (KeySpan) was appropriately included in the Company's Proxy Group and that the Department's exclusion of KeySpan from its Comparison Group was unreasonable. The Company stated that it demonstrated at hearing that KeySpan derives approximately 69 percent of its revenue from its natural gas operations, thereby meeting the Department's earnings screen. The Company asserted that the earnings data relied upon by the Department to exclude KeySpan from the proxy group was out of date prior to the time it conducted its study because it failed to reflect the fact that KeySpan exited the exploration and production business in late 2004 by selling its assets, thereby increasing to 69 percent the percentage of total operations-derived revenue that KeySpan derived from its natural gas distribution operations.

d. The Commission's Analysis

The Commission concurs with the ALJ, accepting and adopting his findings in this regard. The purpose of the Department's earnings screen was to promote selection of companies that investors would identify as engaged primarily in natural gas operations, as is Great Plains. Hence, the reasonableness of the Department's earnings screen that the comparison companies must earn at least 65 percent of their operations-derived revenue from natural gas operations.

In the circumstances presented here, however, the 65 percent rule of thumb does not serve that purpose since KeySpan only met the 65 percent mark late in 2004 through the elimination of its revenues from exploration and production business due to its sale of the assets used to generate such revenues. The fact that sale of these assets happened to result in KeySpan earning more than 65 percent of its operations-derived revenue from natural gas operations that year, therefore, does not mean that investors would identify Keystone as a company (like Great Plains) primarily engaged in natural gas operations. In fact, the sale of its exploration and production business assets would introduce such uncertainty for investors regarding the company's future operations and profitability as to make the company a poor candidate for any comparison group.

Accordingly, the Commission concludes that KeySpan was properly excluded from the comparison group.

3. Denial of the Company's Proposed Flotation Cost Adjustment

The cost of issuing new stock is known as the flotation cost. A flotation cost adjustment can be applied to a company's common equity investment to restrain dilution of existing capital.

a. Background

Great Plains based its proposed flotation cost adjustment on a survey of 34 natural gas and transmission and distribution companies that issued common stock between 1992 and 2002. The average flotation cost of these new issues was 4.77 percent. From that calculation, Great Plains concluded that 4.75 percent was an appropriate flotation cost adjustment.

b. The Department

The Department argued that the survey of equity issuance costs used by Great Plains was outdated. The Department proposed, as an alternative, a figure based in actual equity issuance costs for Great Plains' parent company (MDU) over a period including the four most recent equity years, including the February 2004 issue of $51 million in MDU common stock. The flotation cost for that single issuance was 4.2 percent of the Company's dividend yield and the average flotation cost over the four issues was 4.32 percent of yield.

The Department also objected that Great Plains should not have included the growth-rate component as well as the dividend-yield component in its adjustment method. The Department maintained that the flotation-cost factor should be applied only to the dividend yield component, which compensates for the reduction in the base upon which a company earns, thereby restoring the effective ROE opportunity to that indicated by the discounted cash flow (DCF) method.

c. The ALJ

The ALJ found that the Department’s methodology in calculating Great Plains’ cost of equity issuance is superior to that advanced by Great Plains. The ALJ stated that average costs actually incurred by the Company’s parent (MDU) in equity cases is a better predictor than a survey of other companies’ costs, more or less similar to Great Plains, reaching back to 1992. On the issue whether a flotation cost adjustment should be included on both the dividend yield and growth portion of the DCF or on only the dividend yield, the ALJ found that the Company’s expert witness agreed with the Department that only the dividend-yield component should have been adjusted.

d. Great Plains’ Exceptions to the ALJ’s Finding Regarding the Flotation Cost Adjustment

Great Plains disputed that its witness, Dr. Gaske, had acknowledged that only the dividend-yield component should have been adjusted. While acknowledging that the Company had erroneously added the difference between the Company and the Departments flotation-cost adjustments to the ROE estimate, it contended that this acknowledgment did not impact the reasonableness of its proposed ROE of 11 percent.

Further, Great Plains asserted that the ALJ’s finding that the Department’s methodology in calculating a flotation cost adjustment is superior to that supported by Great Plains does not reflect an appropriate weighing of competing expert testimony and is unsupported by substantial record evidence. The Company stated that the ALJ’s Report did not indicate that the Company’s expert’s testimony was adequately considered and did not provide sufficient justification for adopting the Department’s position.

e. The Commission’s Analysis and Action

The Commission concurs with the ALJ, accepting and adopting his findings in this regard. The Commission has given the Company’s position and witness full consideration but finds that the record in this proceeding does not contain a fully inclusive flotation cost analysis. Noting that the Company, as the proposer of new rates, bears the burden of persuasion that all components of those rates are reasonable, finds that the Company has not borne its burden of persuasion, particularly in light of the available information and methodology supplied by the Department which appears to be a much more reasonable (up to date) approach to calculating the Company’s flotation cost.

As to whether a flotation cost adjustment should be applied to the growth portion of the DCF as well as to the dividend yield or only to the dividend yield, the Commission finds that the flotation cost adjustment should be applied only to the dividend yield. The Company's proposal to apply the flotation cost adjustment to the growth portion of the DCF would count the flotation cost twice because the growth component of the Commission-approved DCF formula represents future increases in the dividend, which itself is already adjusted to reflect the flotation cost. Since the growth component already captures or reflects the flotation cost, treating the flotation cost as an additional separate factor in calculating the growth component would double count that factor.

D. The Department's Cost of Equity Proposal

To develop a group of comparison companies for Great Plains, the Department looked for firms that are natural gas local distribution companies with approximately the same investment risk as the Company. To find comparable companies, the Department choose natural gas LDCs listed in the December 31, 2004 Compustat Database that the following conditions:

1. Part of the Standard Industrial Classification code 4924 (Natural Gas Distribution).
2. Had shares publicly traded on a stock exchange.
3. Were currently paying dividends.
4. Has S&P debt ratings between A+ and BBB.
5. Must be a U.S.-based firm; and
6. 65 percent of the operating income must be from regulated LDC operations.

The Department initially used operating revenue to identify companies but was persuaded that contributions to earnings by natural gas distribution operations is a more accurate criterion. The Department explained that an earnings screen is superior to using operating revenues because a company's ability to pay and increase a dividend accounts for a significant share of the investment risk of a company. The Department arrived at its group of nine companies by eliminating companies that had less than 65 percent of their earnings from natural gas operations.

To calculate the dividend yield, the Department used the trading period of December 2004. It coincides with the growth estimates from Value Line and was the most recent full month for which information was available. This produced an average dividend yield for the group of 4.09 percent.

The dividend yield was then adjusted for the flotation cost of 4.32 percent, based on the weighted-average percentage flotation costs for the five most recent MDU Resources stock issues. The adjustment was made by dividing the expected dividend yield by (1-percentage flotation costs). This adjustment increased the dividend yield to 4.27 percent.

The Department used Earnings Per Share (EPS) and Book Value Per Share (BPS) projected growth rates to find a Value Line average growth rate. The Value Line estimates were averaged with Zacks year growth projections for EPS to produce an expected growth rate of 5.44 percent.

Using the lowest and highest company projected growth rates from Zacks and Value Line, the group averages for these values are 4.52 percent and 6.36 percent.

The combination of the growth rate and dividend yield produced a rate of return of 9.72 percent (from a range of range of 8.78 percent to 10.65 percent) and an overall cost of capital of 8.96 percent.

E. Great Plains' Criticism of the Department's Cost of Equity Recommendation

Great Plains criticized the Department's ROE analysis in three general areas:

First, the Company argued that KeySpan's earnings were sufficient to be included in the Department's comparable group.

Second, the Company argued that the Department ignored the risk factors that increase the cost of capital for Great Plains including company size, lack of geographic and customer diversity when compared to the Comparison group, the fact that the Company's rate resign recovers a substantial portion of fixed costs in volumetric components and does not have a weather normalization adjustment mechanism, and the fact that Great Plain's historical returns are significantly lower as compared to the Comparison Group. Specifically, the Company asserted that use of the midpoint of the range does not accurately reflect the unique risks faced by Great Plains.

Third, Great Plains argued that the Department erroneously made the flotation cost adjustment only to the dividend yield portion of the DCF estimates. The Company asserted that the correct approach applies the adjustment to the entire DCF rate of return.

F. The ALJ's Findings Regarding the Department's Cost of Equity Analysis

The ALJ found that Department's methodology in calculating Great Plains' cost of equity issuance is superior to that advanced by Great Plains, that the average of costs actually incurred in equity issues is a better predictor than a survey of other companies' costs, more or less similar to Great Plains, ranging back to 1992, and that the benefit of a recent bond issue in reducing costs does not distort the resulting average.

The ALJ concluded that the results derived by the Department's analysis accurately reflect the range of comparable companies and the averaging method used appropriately identifies the ROE to be established in this proceeding. The ALJ concluded that the preponderance of the evidence supports the Department-sponsored ROE of 9.72 percent (and the resultant ROR of 8.96 percent), which can be viewed as the sum of a yield of 4.27 percent, a growth figure of 5.26 percent and a flotation cost adjustment of 0.19 percent.

G. The Commission's Analysis and Action Regarding the Department's Proposed Cost of Equity

The Commission concurs with the ALJ, accepting and adopting his findings on this issue. As demonstrated above, the Company's proposed cost of equity over-compensated for risk, miscalculated the flotation cost, and improperly included KeySpan in its comparison group. As a result, its proposed cost of equity is unsatisfactory.

By contrast, the Commission agrees with the ALJ that the Department's proposed cost of equity is reasonable and well-founded. The Commission will adopt the Department-sponsored ROE of 9.72 percent and the resultant ROR of 8.96 percent.

XII. PROPOSED RECOVERY OF PRIOR RATE CASE EXPENSES

At issue in this section is the Company's proposal to recover the unamortized amount from (Docket No. G-004/GR-02-1682) over a three year period and to true-up the amount by which actual 02-1682 rate case costs exceeded the amount the Company included in that rate case filing: $139,175.

A. Great Plains' Proposals

Great Plains proposed to recover, in addition to the projected rate case expenses from this case, the unamortized amount from the previous rate case (Docket No. G-004/GR-02-1682) over a three year period and also to recover (true-up) the amount by which actual 02-1684 rate case costs exceeded the amount included in the rate filing.

In support of its request to recover the unamortized amount authorized in the prior rate case, Great Plains argued that the Commission had approved a three-year amortization of rate case costs beginning January 2004 and running through December 2006. The Company stated that to be fair and reasonable, the Company should be allowed to recover the rate case costs from the prior case.

Regarding its true-up proposal, the Company explained that prior to the previous rate case, the Company had not filed a rate case for 18 years and, as a result, vastly underestimated the charges that would be assessed by the Department and the Commission. The Company stated that not allowing recovery of actual charges in excess of the estimate would provide an incentive to over estimate the cost of a rate case to assure recovery of actual costs.

B. The Department's Response to Great Plains' Rate Case Expense Recovery Proposals

The Department objected to Great Plains including the unamortized costs from it prior rate case in its calculation of ongoing rates because these costs were incurred outside its proposed rate case test year. The Department stated that the test year methodology ensures reasonable rates by matching investment, sales, and expenses of a specific period.

The Department also objected to the true-up proposal to account for the fact that the Company had underestimated its rate case expenses in the prior case. The Department stated that there is no true-up mechanism to account for such differences. The Department noted that Great Plains' last rate case did not include an offset to rate case expenses for the amortization that was built into rates and collected during the 19-year period since its then most recent rate case. The Department argued that the Company's proposal to true-up the rate case expenses from the prior case is not good public policy since it contradicts the well-established concept of test year ratemaking.

C. The ALJ

The ALJ reasoned that under normal rate making policy, a utility is not entitled to recover costs outside its rate case test year period. The ALJ explained that just as the test year concept protects a utility from having to include past out of period revenues in a rate case, it does not allow a utility to include past out of period costs in the current test year. The ALJ stated that this analysis applied both to Great Plains' proposal to recover approved but unamortized rate case expenses and to its proposal to true-up rate case expenses that exceeded the amounts for which it had requested recovery in the previous rate case.

The ALJ noted that Great Plains characterized a prior Commission ruling as allowing a natural gas company to recover rate case expenses from a previous case.[6] The ALJ noted, however, that in that matter, the Commission authorized Minnegasco "to offset the refund of interim revenues by $325,000, representing rate case expenses that have not be recovered from Minnegasco's and Midwest's 1992 rate cases." The ALJ clarified that in the cited case the Commission did not build those prior expenses into rates, as Great Plains has proposed here.

D. Great Plains' Exception to the ALJ's Findings Regarding Great Plains' Rate Case Expense Recovery Proposal

Great Plains took exception to the ALJ conclusion that a utility is not entitled to recover costs outside of its proposed rate case test year period. According to the Company, that finding overlooks the fact that the Commission accepted a three year amortization of rate case expense beginning January 2004 through December 2006.

As an alternative to rate recovery, Great Plains requested Commission authorization to deduct from any interim rate refund any rate case expense authorized in the last rate case but not collected in rates.

E. Commission Analysis and Action Regarding Great Plains' Rate Case Expense Recovery Proposals

The Commission will approve the Company's proposal to recover its estimated costs for the current case ($308,450), amortized over a three year period.

The Company's true-up proposal and the proposal to recover the unamortized portions of prior rate case expenses are not approved, however. Regarding these proposals, the Commission agrees with the analysis and recommendations of the ALJ and the Department. The expenses the Company proposed to recover through these proposals were incurred outside the current test year and, as such, are generally not recoverable. No special circumstances have been shown to warrant different treatment.

XIII. RATE BASE SUMMARY

Based on the foregoing findings, the Commission concludes that the appropriate rate base for the test year is $10,556,439 as shown below:

Gas Plant in Service	
Intangible	$ 114,158
Production	1,177,342
Transmission	1,217,445
Distribution	18,991,785
General	4,093,881
Common	689,589
Common - Intangible	541,003
Total Gas Plant in Service	**$ 26,825,203**

[6] Docket No. G-008/GR-93-1090, October 24, 1994 Order

Accumulated Reserve for Depreciation	
Intangible	$ 104,738
Production	989,901
Transmission	1,071,473
Distribution	11,937,901
General	2,278,170
Common	172,427
Common - Intangible	347,304
Total Accum Res for Depr	**$ 16,901,914**
Total Net Gas Plant in Service	**$ 9,923,289**
Other Rate Base Items	
Materials and Supplies	162,979
Fuel Stocks	65,425
Gas in Underground Storage	763,659
Prepayments	54,014
Accumulated Deferred Income Tax	(412,927)
Accumulated Investment Tax Credits	0
Customer Advances	0
Total Rate Base	**$ 10,556,439**

XIV. OPERATING INCOME SUMMARY

Likewise, based on the foregoing findings, the Commission concludes that the appropriate operating income for the test year under present rates is $663,656 as shown below:

Operating Revenues	
Sales	$ 36,608,114
Transportation	357,435
Other	263,562
Total Operating Revenues	**$ 37,229,111**
Operating Expenses	
Operating & Maintenance	
Cost of Gas	**$ 29,642,482**
Other O&M	
Other Production	$ 43,797
Other Gas Supply	50,348
Transmission	21,320
Distribution	1,625,955
Customer Accounts	1,101,131
Customer Service & Information	(67,057)
Sales	192,769
Administrative & General	2,134,127
Total Other O&M	**$ 5,102,390**
Total Operating Expenses	**$ 34,744,872**

Depreciation & Taxes	
Depreciation	$ 1,039,864
Taxes other than Income	584,094
Current Income Taxes	405,663
Deferred Income Taxes	(209,038)
Total Depr & Taxes	**$ 1,820,583**
Total Operating Expenses	**$ 36,565,455**
Net Operating Income	**$ 663,656**

XV. GROSS REVENUE DEFICIENCY

The above Commission findings and conclusions result in a gross revenue deficiency for the test year of $481,325 as shown below:

Average Rate Base	$ 10,556,439
Rate of Return	8.960%
Required Operating Income	$ 945,857
Operating Income	$ 663,656
Income Deficiency	$ 282,201
Gross Revenue Conversion Factor	1.705611
Revenue Deficiency	**$ 481,325**

XVI. FORECASTING

Sales to interruptible customers and transportation volumes account for approximately one half of Great Plains sales volume. The Company completed a customer-by-customer regression analysis with current information to estimate sales volumes.

A. Positions of the Parties

Great Plains reviewed each customer's use for a three year period and determined the customers whose volumes were weather sensitive. Where gas usage was not weather sensitive, the actual 2003 volumes were reviewed to determine if they reflected current conditions. If they did, actual 2003 volumes were used.

For the customers whose consumption was weather sensitive, Great Plains made individual customer regressions. The customer regressions were based on data for the period 2001-2003, to adjust the actual 2003 volumes to reflect normal weather, consistent with the method used to determine weather normalized firm volumes. Great Plains then calculated revenue using the actual rate schedules under which each customer took service.

The Department objected to the interruptible customer forecasting methodology used by Great Plains:

> The Company utilized the results of its regression analysis regardless of whether the constant was positive or negative. The Department demonstrated that Great Plains' forecast indicated that 38 percent of the interruptible sales and transportation customers were predicted to have a "negative constant". This implies that everything else being held constant, the Company expects these customers' base load usage to be negative for each month in the test year.
>
> The Company did not provide sufficient information to allow replication of the Company's analysis or to evaluate the reasonableness of its analysis.

In response to the Department's concern over the negative constant, the Company indicated that it did not rely on whether the constant was negative or positive to determine if a customer's gas usage was weather sensitive. Instead, the Company relied on the nature of the customer's business and consumption pattern. It argued that broadening the review process to consider customer characteristics provided a better analysis than merely running a statistical correlation.

The Department recommended rejection of the Company's interruptible test-year sales because Great Plains had not shown its data and calculations to be reasonable. The Department noted that the Company did not provide the forecast indicating how each individual interruptible customer was treated.

The Company described the categories of information used to adjust the forecasts for individual customers, however, there was no description as to how this information was applied to any individual customer to a degree of specificity that would permit the Department to replicate the Company's calculations. The Department indicated that the Company's responses to discovery on this issue were similarly vague.

In the alternative forecast, the Department recommended that the Commission use the interruptible sales and transportation volumes approved as part of Great Plain's most recent rate case as a proxy. The Department clarified that it did not sponsor the proxy, but suggested that it be used as an alternative to denial of the Company's rate increase request in its entirety.

Based on a comparison of Great Plains' actual volumes for 2003 and 2004 to the volumes that were approved in the 2003 Rate rider, the Department suggested that the use of the actual volumes would be reasonable. The forecast volumes in the 2003 Rate Order were higher than the volumes actually sold by Great Plains. However, the actual volumes have been increasing, and can reasonably be expected to be comparable to those volumes forecast in the earlier matter.

Great Plains argued that the Department's proposal to use the volumes from the last rate case is incorrect. Great Plains argued that the Department's forecast did not reasonably reflect expected customer conservation, and used outdated interruptible volumes. The Company argued that these factors do not reflect current conditions, and maintained that the Department's forecast would substantially overstate test year revenue.

The ALJ stated that the issue was not whether the Company, the Department, or the ALJ were satisfied with the accuracy of any particular forecast. What must be determined is whether the Commission can conclude that the charges are "just and reasonable.” In rejecting Great Plains’ forecasting method, the ALJ stated:

> The methodology used by Great Plains relies on individual adjustments, to an undisclosed degree and based on unidentified criteria, to customer usage estimates. This approach is not transparent and the method used cannot be replicated for analysis. Using that methodology, 38 percent of the customers in the class being analyzed returned anomalous results. The Department has demonstrated that Great Plains' forecast for interruptible sales and transportation volumes is unreliable. [7]

The ALJ accepted the Department's recommendation to use the same methodology and volume information that supported the 2003 Rate Order.

B. Commission Action

The Commission concurs with the ALJ and accepts and adopts his findings and recommendations on this issue. The Commission finds that transparency in forecasting method ensures that the calculation has not been manipulated to favor a desired outcome. Statistical reliability provides some reassurance that an appropriate method has been used.

The Company's approach is not transparent and the method used cannot be replicated for analysis. The Company's approach returned anomalous results for 38 percent of the customers in the class being analyzed. The Department has demonstrated that Great Plains' forecast for interruptible sales and transportation volumes is unreliable. The Company's forecast for interruptible sales is not supported by the record.

As an alternative to dismissing this proceeding, the Department proposed using the same method and volume information that supported the 2003 Rate Order. With this approach, the volumes for Crookston, North 4, and South 13 areas that were used to project the 2003 test year revenues were used to determine the 2005 test year revenues.

On the record in this proceeding, the Commission finds that the Department's approach provides a reasonable basis for rate setting. Applying the volumes that supported the 2003 Rate Order results in an estimated sales revenue adjustment of $1,291,484, and an increase of $1,060,457 in gas costs.

XVII. RATE DESIGN

A. Future CCOSS Studies (Area Desegregation)

1. Positions of the Parties

The Department recommended that the Company provide a CCOSS for each rate area as well as a CCOSS for the entire company in its next general rate case. Although the Company has multiple rate areas with different rates, it filed a single CCOSS for the entire company. The Commission's approval of the Company's increase in the last rate case was based on a CCOSS produced on a total of Great Plains-MN costs for the various customer classes.

Great Plains asserted that the costs underlying the CCOSS are not maintained on the Company's books in a manner that would readily allow a separate CCOSS to be developed for each rate area.

---

[7] ALJ Finding 51, Report of the Administrative Law Judge.

The benefit of having the CCOSS broken out by rate area is offset by the need to introduce additional divisions of the corporate allocation factors. Great Plains argued that the additional time and expense to prepare the CCOSS broken out by rate area was not likely to provide a more accurate rate setting. According to the Company, the costs associated with providing a CCOSS for each rate area were simply not justified.

In response to the Department's requests for discovery for information broken out by rate area, Great Plains indicated that the information was unavailable. The Department argued that the failure to maintain this data renders cost data review on a rate-area-by-rate-area basis to be impossible. The Department asserted that this information was necessary to determine whether the individual rate areas are paying for the costs they impose upon the system.

The ALJ recommended that the Commission allow Great Plains to rely upon a single CCOSS for Great Plains' future rate setting.[8]

2. Commission Action

The Commission agrees with the ALJ and the Company that Great Plains should be allowed to rely on a single CCOSS for its entire service area. A single CCOSS is an adequate method for estimating the Company's costs to provide service. There is no current need for the type of study recommended by the DOC.

B. Fixed Rate Customer Charge

The Company proposed the following basic service charges in this case:

Class	**Current Monthly Charge**	**Proposed Monthly Charge**
Residential	$5.50	$8.00
Firm General Service < 500 CF per hour	20.00	20.00
Firm General Service > 500 CF per hour	20.00	25.00
Small Interruptible - Sales	100.00	125.00
Small Interruptible - Transport	175.00	175.00
Large Interruptible - Sale	200.00	200.00
Large Interruptible - Transport	250.00	250.00

Great Plains proposed increasing the amount of fixed charges recovered under certain rate schedules to a more compensatory fixed charge rate. The basis for the increased amounts that Great Plains proposed is the customer component identified in the CCOSS.

[8] ALJ Findings 179 - 180, Report of the Administrative Law Judge.

Great Plains proposed to increase the Basic Service Charges for the residential classes, certain customers taking service under the General service classification, and the small interruptible sales class.

1. Residential Rate Customer Charge

The residential customer charge is a fixed monthly charge assessed without regard to usage levels. It is designed to recover fixed costs that do not vary with usage, such as constructing and maintaining infrastructure, reading meters, and conducting billing and collection services.

The customer charge has two main functions, one practical and one grounded in ratemaking policy. Its practical function is to help stabilize utility revenues and reduce the risk that the utility will over- or under-recover its revenue requirement due to weather-related fluctuations in gas usage and sales. Its ratemaking function is to ensure that each customer bears responsibility for a certain level of the Company's fixed costs regardless of usage.

Theoretically, the Company recovers its revenue requirement whether customer charges are high or low; all the costs it is authorized to recover are built into either the customer charge or usage charges, which are carefully calibrated, based on normalized weather data and forecasted sales volumes, to yield the authorized revenue requirement. As a practical matter, however, companies usually prefer the certainly of fixed monthly customer charges to the fluctuation of usage charges.

Great Plains' current monthly residential customer charge is $5.50; that charge is on the lower end of the range of residential charges approved for Minnesota's natural gas utilities. [9]

a. Positions of the Parties

Great Plains argued that it demonstrated that the basic service charge for residential customers would need to be $19.67 to accurately reflect the residential customer's fixed cost responsibility under the CCOSS. Great Plains proposed that its basic service charge be increased to $8.00.

The Department agreed that a residential customer charge should move closer to cost over time. When weighed against the need for recovery of costs, the proper apportionment across customer classes, the avoidance of rate shock, and the ease of understanding billings, the Department concluded that increases to the basic service charge would be inappropriate. [10]

The Department argued that approximately eight months prior to the filing of this rate case, Great Plain's residential gas customers in Crookston experienced a near 41 percent increase in their basic monthly service charge with North 4 and South 13 residential customers receiving approximately 134 percent increase in their basic monthly service charge. The Department asserted that Great Plains has not shown that it is reasonable to increase customer charges an additional 45 percent so soon after raising the charges by 41 percent and 134 percent; such increases would constitute a drastic increase.

---

[9] Currently, other natural gas utilities' monthly customer charges are as follows: Alliant Energy - Interstate Power, $5.00; Aquila Networks-NMU, $5.50; Aquila Networks-PNG, $6.50; Minnegasco, $6.50; Xcel Energy, $8.00.

[10] ALJ Findings 165 - 166, Report of the Administrative Law Judge..

Great Plains correctly pointed out that a corresponding decrease in the distribution charge would go along with any increase in the basic monthly service charge. However, according to the Department, to increase the basic service charge an additional $2.50, or 45 percent, would mean that residential customers would face an increase of approximately 240 percent over a two year period ($8.00-$2.35 = $5.65/$2.35 = 240 percent). The Department considered such an increase to be drastic, and unreasonable.

Great Plains pointed to the Department's support, and the Commission's acceptance, of an increase of the basic service charge to $8.00 in Docket No. G-02/GR-04-1511. [11] In accepting the parties' settlement proposal to increase residential customer charges, the Commission specifically recognized that gradual movement toward actual cost has certain benefits for customers.

The Department pointed out that Great Plains did *not* discuss the fact that the Commission had recently *rejected* CenterPoint Energy's request for an increase in the amount of its service charge to $8.00, allowing instead a basic charge of $6.50. [12]

The ALJ found that allowing a significant increase from the current $5.50 residential customer service charge, so soon after the large jump in that charge, [13] would constitute rate shock. [14] In rejecting the Company's proposed increase in the residential Basic Service Charge, the ALJ agreed with the calculations of the Department, that under the Company's proposal, residential customers would face an increase of approximately 240 percent over a two year period. On this basis, the ALJ declined to recommend such an increase.

b. Commission Precedent

Rate design decisions are policy-intensive and are made as part of the Commission's quasi-legislative function. In rate design the Commission continues to base its decisions on the facts in the record, but it also draws heavily on its institutional expertise, experience, and judgment.

In the recent CenterPoint Energy rate case, the Commission summed up its experience with residential customer charges as follows:

---

[11] *In the Matter of an Application by Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in the State of Minnesota*, Docket No. G-002/GR-04-1511, Order Accepting and Modifying Settlement And Requiring Complainance Filings (August 11, 2005).

[12] *In the Matter of an Appliocation by CenterPoint Energy Minnegasco, a Division of CenterPoint Energy Resources Corp., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-04-901, Order Accepting and Modifying Settlement and Requiring Compliance Filing (June 8, 2005).

[13] In approximately January 2004, Great Plains' residential basic servic charge increased by $3.15 per month. [cite]

[14] ALJ Findings 165-169, Report of the Administrative Law Judge

> In final Orders in the past several rate cases in which the Commission has examined customer charges, it has expressed grave reservations about permitting greater reliance on these ratemaking devices. Customer charges tend to confuse and alienate customers, neutralize conservation incentives, burden low income households, and perpetuate pricing structures ill-suited to competition. For these reasons, the Commission will maintain Minnegasco's customer charges at their current levels.
>
> Customer charges are especially troublesome in the residential context. The cardinal goals in residential ratemaking are making rates understandable, making them easy to administer, and maintaining public confidence in their fairness. Customer charges work at cross purposes with these goals. [15]

c. $8.00 Residential Customer Charge Rejected as Excessive

Having examined the record as a whole, the Commission concludes that the increase to $8.00, as proposed by the Company, is excessive and not in the public interest. Here, the increase requested would result in an increase in residential rates of an additional $2.50 per month, which translates into an increase of 240 percent over a two year period. The Commission believes this is excessive. While the Commission believes that some increase in the basic service charge is warranted, it is not prepared at this time to award the $8.00 requested.

The Commission recently has had the opportunity to consider a proposed increase to basic service charges. In the *Minnegasco* rate case decided last year, the parties proposed a settlement in which both parties supported an increase from $5.00 to $8.00 for the customer charge. Minnegasco had not sought a rate increase since 1992. The parties presented the settlement proposal "as a reasonable means of stabilizing utility revenues, preventing or reducing high-usage customers' subsidization of low-usage customers' bills, and reducing fluctuations in the monthly bills of customers not using levelized monthly payment options." [16]

The Commission rejected the proposed increase of Minnegasco's rates to $8.00 for three reasons - "the potential for adverse impacts on low-income households, the statutory directive to set rates to encourage conservation and renewable energy use, and the strong public interest in maintaining clear and credible residential utility rates."[17]

---

[15] *In the Matter of an Application by CenterPoint Energy Minnegasco, a Division of CenterPoint Energy Resources Corp., for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-04-901, Order Accepting and Modifying Settlement and Requiring Compliance Filing (June 8, 2005) at 6-7, *quoting*, *In the Matter of the Application of Minnegasco, a Division of NorAm Energy Corp., for Authority to Increase Its Natural Gas Rates in Minnesota*, Docket No. G-008/GR-95-700, Findings of Fact, Conclusions of Law and Order (June 10, 1996) at 64-65.

[16] Id. at 5.

[17] Id. at 7.

The Commission continues to adhere to the rationale set forth in the *Minnegasco* rate case. The Commission has consistently viewed high customer charges as burdensome to low-income households, and it continues to do so. A 1997 study by the United States Department of Energy confirms the clear correlation between household income and natural gas usage, with usage rising as incomes rises.[18]

In addition, maintaining the clear link between consumption and cost is central to the Public Utilities Act's stated goal to set rates to encourage conservation and renewable energy use "to the maximum reasonable extent." Minn. Stat. § 216B.03. The Commission has held that customer charges, by definition, weaken this link. [19]

Finally, the reasons proffered by Great Plains to justify the requested increase in rates within two years of its last increase - the move toward a cost based rate, and reduction of inter- and intra-class subsidization - do not justify its adoption at this time.

d. $6.50 Residential Customer Charge Adopted

While the Commission is not persuaded to accept Great Plain's proposed $2.50 increase in residential rates, it will impose an increase of $1.00, to set residential rates at a total of $6.50. This increase brings Great Plains' rates into line with that awarded Minnegasco last year and other Minnesota utilities.

The $1.00 increase moves the residential customer charge closer to cost, which the Department acknowledges is a positive outcome. In addition, as Great Plains' price moves closer to cost, the current proceeding provides an opportunity to accomplish that rate rebalancing objective. Such a step will help to reduce the intra-class subsidies that currently exist in the rate structure, where, high use customers subsidize low use customers as a result of the rate structure.

According to testimony at the hearing, an increase in the Company's basic service charge will be accompanied by a corresponding decrease in the energy charge portion, thus benefitting customers in higher use winter months, and mitigating possible rate shock.

Finally, despite the Department's valid concerns about the percentage increase in Great Plains' residential rates in the last 24 months, the rates, even with the increase, remain under $10.00.

2. Firm General Service Customers

a. Positions of the Parties

Great Plains proposed to differentiate between small and large customers taking service under the Firm General Service rate classification based upon size of the meter installed to meet their gas requirements. Those customers using the smaller rated meter (less than 500 cubic feet per hour)

---

[18] U.S. Department of Energy, Energy Information Admnistration, Residential Consumption Survey, 1997. (Http://www.eia.doe.gov/emeu/consumptionbriefs /recs/natgasincome.html).

[19] Id. at 8.

would continue to pay a Basic Service charge of $20.00 per month. Customers with larger gas requirements (greater than 500 cubic feet per hour) would pay an increase of $5.00 per month, or $25.00.

The Company's witness, Ms. Aberle, testified at the hearing that in order for the class to move to a cost based level, the Company would need to implement a basic service charge of $45.70. Further, Great Plains argued that it demonstrated that the average cost of the meter type used for measuring gas flows greater than 500 cubic feet per hour is significantly higher than the meter used for customers in the class using the smaller meter types.

The Department objected to any increase in basic service charges for this class, citing recent large increases in the monthly service charge for the Crookston firm general service customers and the North 4 and South 13 general service customers which occurred in January 2004.

The ALJ recommended that the monthly basic firm general service charge remain at its current rate. [20]

b. Commission Action

The Commission will permit the Company's requested increase of $5.00 per month for the larger gas meter to a total rate of $25.00 per month.

Here, it will be the highest use customer who will be providing the greatest contribution to fixed costs. While both the $20.00 and the $25.00 rates continue to be well below cost, this relatively small increase for the high end users will benefit customers in the entire class, by reducing the distribution charges paid by the entire class. Further, the small increase will move large customers toward cost.

3. Small Interruptible Customers

a. Positions of the Parties

Great Plains proposed an increase of $25.00 per month to its basic service charge for its small interruptible sales class, bringing the total charge to $125.00 per month. The Company asserted that this increase is supported by the CCOSS and, as with the other classes, represents a gradual movement toward cost. The Company argued that to accurately reflect the customer's fixed responsibility under the CCOSS, the basic service charge would need to be $331.46.

The Department argued that, as with the other classes, any additional increase in charges at this time would constitute a drastic increase. The ALJ agreed with the Department, and found that any additional increase to the basic service charge at this time would constitute rate shock. [21]

---

[20] ALJ Finding 170, Report of the Administrative Law Judge.

[21] ALJ Finding 171, Report of the Administrative Law Judge.

b. Commission Action

The Commission will permit the Company's requested increase of $25.00 per month for the small interruptible customers to a total rate of $125.00 per month. Again, the Commission finds that allowing the relatively small increase will move rates toward cost for those large customers with the ability to pay.

D. Timing of Rate Consolidation for Crookston and North 4 Rate Areas

The Commission's October 9, 2003, Order, accepting the settlement reached by the Company and the Department in Great Plains' last general rate case, Docket G -004/GR-02-1682, ordered the Company to modify the two-step, three year phase in of the consolidation of the Crookston and North 4 rate structures. The Order establishes that the first step is to occur one and a half years from the date final rates go into effect and the second step is to occur at the end of three years.

1. Positions of the Parties

Great Plains proposed to continue the approved phase-in of the rate consolidation, with consolidation complete in January or February 2007. Great Plains also proposed to delay the second step of the phase-in until rates in this case are final, so as to minimize customer confusion by not changing rates under the phase in plan previously approved during the time interim rates were being collected in this case.

The Department recommended that the 36 month phase-in of the consolidation of the Crookston and North 4 rate areas recommence with the issuance of the final Order in the present rate case. The Department argued that the departure in timing from the Commission's Order in G-004GR-02-1682 was necessary to prevent customer confusion as to what was the cause of the change in rates (the previously ordered consolidation, or the new rates).

The ALJ found that "[s]hould the Commission accept the adjustment to Great Plains' revenue deficiency that are proposed in this Recommendation, neither rate shock nor customer confusion will result from an immediate initiation of phase 1." [22]

The ALJ found that the phase-in plan proposed by Great Plains was designed to move rates toward cost without causing rate shock.

2. Commission Action

The Commission agrees with Great Plains and the ALJ. The current schedule for the consolidation of the rates for the Crookston and North 4 rate areas will be maintained, with one clarification to the ALJ finding. The final sentence of Finding 177 should read "[s]hould the Commission accept the adjustment to Great Plains' revenue deficiency that are proposed in this Recommendation, neither rate shock nor customer confusion will result from an immediate initiation of *phase 2*."[23]

[22] Finding 177, Report of the Administrative Law Judge.

[23] Finding 177, Report of the Administrative Law Judge (emphasis added).

The Commission will not reset the start date for the consolidation of rates for the Crookston and North 4 rate areas, as requested by the Department. While the Department emphasized the importance of gradual rate increases, the Commission finds that resetting the start date would unduly delay the alignment of rates that the Commission has determined to be just and reasonable. An immediate adjustment to rates, reflecting the alignment of the North 4 and Crookston rate areas, is approved.

UNCONTESTED MATTERS

The following issues have been resolved as recommended by the ALJ and to the mutual satisfaction of the parties. Based on its own review of the record, the Commission further finds that these issues are properly resolved, in the public interest, and supported by substantial evidence in the record.

XVIII. UNCONTESTED FINANCIAL ISSUES

A. General Allocator

The Commission finds that the Company's two factor allocator is not comparable to the preferred allocator. Consequently, the allocations from MDU are reduced by $215,596 and the allocations from Montana Dakota are reduced by $51,188.

B. Corporate Costs

The Commission finds that the 2003 actual results can not be relied upon to set just and reasonable rates and must be reduced by $149,945 with offsetting adjustments for merger savings for Gas Supply and Regulatory Affairs, GIS and insurance. The Commission notes that the parties agree that adjustment results in zero net change.

C. Time Study

The Commission finds that the time study does not appropriately reflect the time spent on combined regulated/non-regulated activities and that an adjustment of $49,034 is required.

D. Executive Incentive Compensation

The Commission finds that the Executive Compensation Incentive compensation includes amounts that are for the benefit of shareholders and should not be recovered from ratepayers. The reduction is $62,059.

E. CIP Cost Recovery

The Commission finds that the appropriate cost recovery method for CIP costs is the volumetric method where the test year cost is divided by test year sales resulting in an equal rate for all customer classes.

F. Cost of Capital

Regarding the Company's capital structure, the Commission adopts the company's proposed capital structure of 43.535 percent long term debt, 4.557 percent preferred stock, and 51.908 percent common equity, as supported by the Department and the ALJ.

Regarding the Company's cost of debt, the Commission adopts the Company's proposed costs of long term debt and percent preferred stock of 8.518 percent and 4.614 percent as supported by the Department and the ALJ.

G. Additional, Miscellaneous Uncontested Financial Issues

The Commission determined that the Bad Debt expense should be reduced by $15,239, that advertising should be reduced by $206, and that the Rate of Return (ROR) to be used as the CIP Tracker Carrying Charge is the ROR most recently approved by the Commission for either interim or final rates.

XIX. UNCONTESTED FORECASTING ISSUE

The Commission finds that the Department's Residential and Firm Rate Classes Forecast is more appropriate for setting rates. The Commission will adopt the Department's proposed modifications for the test year.

XX. UNCONTESTED RATE DESIGN ISSUES

A. Class Cost of Service Study

The Commission will adopt the Class Cost of Service Study (CCOSS) as filed by the Company. In the Company's next rate case, the Commission will require Great Plains to include the Transportation Classes in its CCOSS Study.

B. Revenue Responsibility Apportionment

The Commission will direct the Company to apportion the relative revenue responsibility based on an across the board increase of 3.83 percent.

C. Extension Policy Issues

The Commission approves and accepts the extension policy issues agreed upon or addressed in the finding of the ALJ. The Commission will direct the Company to address in the compliance filing or a separate miscellaneous tariff filing the extension policy issues not agreed upon by the parties or addressed in the ALJ's findings.

XXI. UNCONTESTED COMPLIANCE ISSUES

A. Revised Schedules

The Commission will direct the Company to file, within 30 days of the issuance of the Order, revised schedules and rates and charges reflecting the revenue requirements for annual periods beginning with the effective date of the new rates.

B. Rate Refund

If this Order results in a interim rate refund, the Commission will require the Company to file, within 30 days of the Order, a proposed plan for refunding to customers, with interest, the revenue collected during the Interim Rate period in excess of the final rate amount authorized by the Commission.

ORDER

1. The Commission hereby accepts and adopts the recommendation of the Administrative Law Judge in this case, except as to service charge issues, as discussed in the text of this Order..

2. The Commission finds that Great Plains Natural Gas Company (Great Plains or the Company) has demonstrated a test-year revenue deficiency of $ 481,325, based on an overall rate of return of 8.96 percent, a 8.518 percent cost of debt, and a 9.72 percent cost of equity.

3. The Commission determines that the Company's two factor allocator is not comparable to the preferred allocator and reduces allocations from MDU by $215,596 and from Montana Dakota by $51,188.

4. In calculating test year corporate costs, the Commission determines that the 2003 actual corporate costs minus the adjustments made elsewhere in this motion must be further reduced by $149,945 and then subjected to the following adjustments which, taken together, equal $149,945: upward adjustments for 1) merger savings in Gas Supply costs, 2) merger savings in Regulatory Affairs costs, 3) GIS costs, and 4) insurance costs. When all these upward adjustments have been made, the result is a zero net adjustment to the 2003 actual corporate costs.

5. The Commission determines that the Company's time study does not appropriately reflect the time spent on combined regulated/non-regulated activities and that an adjustment of $49,034 is required.

6. The Commission determines that the test year rate case expense is $308,450 and that it should be amortized over 3 years.

7. The Commission determines that the unamortized rate case expense is not a current test year cost and can not be recovered in rates in this case.

8. The Commission determines that rate case income and expenses are not trued up from rate case to rate case and that the true up of $139,175 is not recoverable from ratepayers.

9. The Commission determines that the Executive Compensation Incentive compensation includes amounts that are for the benefit of shareholders and should not be recovered from ratepayers, resulting in a reduction of $62,059;

10. The Commission determines that Bad Debt expense should be reduced by $15,239, that advertising should be reduced by $206.

11. The Commission determines that the Rate of Return (ROR) applicable to the CIP Tracker Carrying Charge will be the ROR most recently approved by the Commission, whether that be in its Order setting interim rates or in its Order setting final rates.

12. The Commission determines that the appropriate cost recovery method for CIP costs is the volumetric method where the test year cost is divided by test year sales resulting in an equal rate for all customer classes.

13. The Commission adopts (1) the Company's proposed capital structure of 43.535 percent long term debt, 4.557 percent preferred stock, and 51.908 percent common equity, as supported by the Department and the ALJ; and (2) the Company's proposed costs of long term debt and percent preferred stock of 8.518 percent and 4.614 percent as supported by the Department and the ALJ. In addition, the Commission finds that the Department's DCF analysis appropriately represents the Great Plains' cost of equity and adopts the Department's proposed cost of equity of 9.72 percent and resulting 8.96 percent rate of return.

Forecasting

14. The Commission finds that the Department's Residential and Firm Rate Classes Forecast is more appropriate for setting rates than the Company's and adopts the Department's proposed modifications for the test year.

15. The Commission finds that the Department's recommendation to use the actual volumes approved in the 2003 Rate Rider is more appropriate for setting rates and adopts it.

Rate Design

16. The Commission adopts the Class Cost of Service Study filed by the Company.

17. Great Plains shall include the Transportation Classes in the CCOSS in its next general rate case.

18. Great Plains need not produce a CCOSS for each rate area in the Company’s next general rate case.

19. The residential customer charge shall be increased from $5.50 per month to $6.50 per month.

20. The monthly customer service charge shall be increased by $5.00 per month for Firm General Service Customers using greater than 500 cubic feet of gas per hour (the rate would increase from $20 to $25 per month).

21. The monthly customer service charge shall be increased by $25.00 per month for Small Interruptible Customers, from $100 to $125 per month.

22. The relative revenue responsibility shall be apportioned based on an across the board increase of 3.83 percent.

23. The current schedule for the consolidation of the rates for the Crookston and North 4 rate areas shall be clarified by adjusting the final sentence of the ALJ's Finding 177 to read as follows: "Should the Commission accept the adjustment to Great Plains' revenue deficiency that are proposed in this Recommendation, neither rate shock nor customer confusion will result from an immediate initiation of ~~phase 1~~ Phase II."

24. The extension policy issues agreed upon or addressed in the findings of the ALJ are approved or accepted. The extension policy issues not agreed upon by the parties or addressed in the ALJ's findings shall be addressed in the compliance filing or a separate miscellaneous tariff filing.

Compliance

25. Within 30 days of the issuance of this Order, the Company shall file revised schedules and rates and charges reflecting the decisions made in this Order, including the revenue requirements for annual periods beginning with the effective date of the new rates.

26. If the Commission decision and Order results in a interim rate refund, the Company shall file, within 30 days of the Order, a proposed plan for refunding to customers, with interest, the revenue collected during the Interim Rate period in excess of the final rate amount authorized by the Commission.

27. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

This document can be made available in alternative formats (i.e., large print or audio tape) by calling 651-201-2202 (voice) or 1-800-627-3529 (MN relay service)